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SUBJECT: BAHRAIN'S STOCK MARKET PERFORMANCE

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SUMMARY  
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11. (U) Like its GCC neighbors, Bahrain's stock market has declined amid the regional market's plummet, but has withstood the ordeal better than most. The Bahrain Stock Exchange (BSE) did not have as far to fall, having seen little of the surge in equity share prices evidenced elsewhere in the region since early 2005. The BSE's lack of volatility is partly due to consumer lending regulations that discourage borrowing to fuel speculative investment. In Bahrain's diversifying economy, surging oil revenues have not played a central role in the market's performance, as in other GCC countries. Conservative investors and a shallow market also explain the BSE's relative stability. The BSE's relative lack of volatility may trigger increased interest from international investors in general and U.S. investors in particular, but until the pool of available shares increases, investors will find it difficult to translate this interest into market activity. End Summary.

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BAHRAIN MARKET HITS LOW FOR YEAR  
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12. (U) The Bahrain Stock Market (BSE) dipped to 1996.68 on June 27, its lowest level of the year. In a decline that began in February, the market gave back all of the gains accumulated since August 2005. By the end of May, the BSE's market capitalization had dropped to BD 6.37 billion (approximately USD 17 billion) from BD 6.99 billion (approximately USD 19 billion) at the end of January. The BSE is currently down 9.1 percent for the year and 14.9 percent off the 2347.01 high set on February 1. However, compared to several more volatile Gulf markets, the BSE's performance has been relatively stable. The Omani market has lost just 0.7 percent, but losses in the other GCC markets have ranged from 12.7 to 56.7 percent.

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LESS BUBBLE TO BURST  
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13. (U) Bahrain's market declines for the year have thus far remained in the single digits because it did not participate in the bull market run-up which had begun for most Gulf markets by January 2005. Bahrain Stock Exchange Management Director Fouad Rashid told the Ambassador June 20 that "the market moves in a narrow range in Bahrain." According to the July 1 Bahrain Tribune quoting Bahrain Monetary Agency (BMA) Executive Director of Banking and Supervision Khalid Hamad, "strict BMA consumer finance regulations discourage heavily leveraged share purchases with the result that "the vast

majority of share purchases made by Bahraini residents in 2005 and 2006 have been made from holdings of cash. Therefore, the upside in 2005 was significantly less and the downslide was also far more restrained than that of our neighbors."

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DIVERSE ECONOMY, CONSERVATIVE INVESTORS  
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¶4. (U) Hamad also noted that, "Less than 30 percent of the national economy is oil-related. This has meant that the Bahrain economy has witnessed steady, modest growth, and has not been swamped with liquidity from oil price rises." Bahrain's market has been less volatile due to the conservative nature of Bahraini investors. Share ownership is dominated by diversified strategic long-term investors. University of Bahrain Professor of Economics Dr. Jassim Hussein recently explained to Econoff that local investors have historically held shares for the long-term. He also noted that the GoB, itself a significant investor in the market, favors long-term investments.

¶5. (U) Securities and Investment Company Principal Broker Fadhel Makhlooq told Econoff July 2 that because a sizable percentage of shares in the 49 companies currently traded on the BSE are held by conservative investors, there are relatively few shares available to trade at any given time. The resulting small pool of available shares represented an unattractive environment to regional short-term speculators flush with oil revenues. Even after regional markets began to collapse, the BSE lacked the depth to absorb fresh currency from recently liquidated investments in other regional markets. (Note: There are 49 companies currently traded on the BSE. Of these, 42 are Bahraini, three are

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Kuwaiti, two are Omani, one is Qatari and one is Sudanese. End Note.)

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BAHRAIN HOSTS REGIONAL SECURITIES WORKSHOP  
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¶6. (U) Public interest in transparency and regulation in the capital markets has been spurred by the recent market slump. The fourth annual workshop on securities market regulation June 28-30, organized by the Financial Services Volunteer Corps and the U.S. Securities and Exchange Commission and sponsored by MEPI received favorable press coverage. Opening the workshop, BMA Governor Rashid Maraj observed, "If investors do not have confidence in the fairness, efficiency and transparency of the market, they will feel that they are not being adequately protected and will move out of the market in pursuit of better opportunities elsewhere." Rashid addressed an audience of securities exchange officials, brokers and dealers from Bahrain, Egypt, Iraq, Jordan, Kuwait, Morocco, Oman, Tunisia, UAE and Yemen.

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COMMENT  
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¶7. (U) Once the market perceives that the BSE has bottomed out, its conservative performance may spur new interest for investors seeking stability over double-digit yields. This interest apparently extends beyond Bahrain and even the region. BSE Head of Public Relations and Marketing told Econoff June 20, "After Bahrain, we expected to see the majority of hits on our web site coming from Saudi Arabia, but to our surprise they are coming from the U.S." With implementation of the U.S.- Bahrain Free Trade Agreement, U.S. interest will likely increase. However, until the pool of available shares increases, investors will find it difficult to translate this interest into market activity. End Comment.

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